



February 2011

Client Advisory

Another Offshore Voluntary Disclosure Initiative

On February 8, 2011, the IRS announced a new voluntary disclosure program for unreported foreign account income. The new program, called the Offshore Voluntary Disclosure Initiative (OVDI), is similar to the program the IRS undertook in 2009 to encourage taxpayers to come forward and disclose their unreported foreign accounts and income in return for an overall cap on penalties and avoidance of criminal prosecution. So as not to reward those who failed to come forward during the 2009 program, penalties will be higher than under the 2009 version, with two exceptions. Except as detailed below, the OVDI requires taxpayers to pay a penalty of 25% of the amount in the foreign bank accounts in the year with the highest aggregate account balance covering the 2003-2010 time period.

12½% Penalty

The 2011 Voluntary Disclosure Program establishes a new penalty category that will apply for smaller, offshore accounts where the offshore accounts or assets did not surpass \$75,000 in any calendar year from 2003 to 2010. Taxpayers seeking this lower penalty amount will need to show that the U.S. Dollar value of the account or combined accounts never exceeded \$75,000 during the disclosure period.

Special 5% Penalty

As was the case in 2009, some taxpayers will be eligible to qualify for a lower 5% penalty. The IRS has provided new guidance as to persons who can qualify for the 5% penalty. All four of the following conditions must be satisfied to qualify for this low penalty:

1. Taxpayer did not open or cause the account to be opened, such as through inheriting an account.
2. Taxpayer exercised minimal, infrequent contact with the account.
3. Taxpayer must not have withdrawn more than \$1,000 from the account in any year covered by the voluntary disclosure period, except for a withdrawal closing the account and transferring the funds to an account in the United States.
4. Taxpayer can establish that all applicable U.S. taxes have been paid on funds deposited into the account (i.e., only account earnings have escaped U.S. taxation). In other words, the funds deposited into the account must not represent funds that came from untaxed activities.

Procedures for Qualifying

As was the case with the earlier program, taxpayers will be required to file amended returns for all years going back to 2003 and pay interest and accuracy and/or delinquency penalties arising from any unreported income. In addition, the flat penalty amount arising from the OVID program – whether it is a 5, 12½ or 25% rate – will need to be paid when the application is filed. The flat penalty is intended to replace all of the penalties arising from failing to file Foreign Bank And Financial Account Reports (FBARs) and other foreign information reports that are required to be filed.

The time frame for applying for this program is very short as it requires participants to file all original and amended tax returns and include payment for taxes, interest and accuracy-related penalties by August 31, 2011. These requirements are far more onerous than under the 2009 program, as they mandate returns and payment of tax up front. The 2009 program only required an information statement to be filed by the application deadline. Under that program, the filing of returns and the payment of penalties was deferred until the IRS had reviewed the application and supporting information. As a result, it can be anticipated that fewer persons will elect to participate in this new program than in the 2009 program. Getting the information needed to enter the program can be difficult and time-consuming, as many foreign account institutions do not maintain the records that a U.S. taxpayer needs to accurately report their income. Taxpayers intending to participate in the program should begin early by contacting their tax advisor and requesting foreign account information.

For additional information on this topic, please contact Kenneth E. Ahl in the Philadelphia office of Archer & Greiner at 215-246-3132 or kahl@archerlaw.com.

DISCLAIMER: *This client advisory is for general information purposes only. It does not constitute legal advice, and may not be used and relied upon as a substitute for legal advice regarding a specific legal issue or problem. Advice should be obtained from a qualified attorney licensed to practice in the jurisdiction where that advice is sought.*